

LARRY W. GABRIEL - Bar No. 68329  
JENKINS MULLIGAN & GABRIEL, LLP  
21650 Oxnard Street, Suite 500  
Woodland Hills, CA 91367  
Telephone: (818) 827-9000  
Facsimile: (818) 827-9099  
Email: lgabriel@ebg-law.com

Special Litigation Counsel or Bradley D. Sharp,  
Chapter 11 Trustee, Estate of C.M. Meiers  
Company, Inc.

**UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA  
SAN FERNANDO VALLEY DIVISION**

In re

C.M. MEIERS COMPANY, INC.,  
  
Debtor.

BRADLEY D. SHARP, CHAPTER 11  
TRUSTEE, ESTATE OF C.M. MEIERS,  
COMPANY, INC.,

Plaintiff,

vs.

ESSEX INSURANCE COMPANY, INC.  
  
Defendant.

Case No. 1:12-bk-10229-MT

Chapter 11

Adv. No. 2:14-ap-01042-MT

**TRUSTEE'S REPLY TO DEFENDANT  
ESSEX INSURANCE COMPANY, INC.'S  
OPPOSITION TO PLAINTIFF'S  
MOTION FOR SUMMARY  
JUDGMENT**

DATE: December 3, 2014

TIME: 1:00 p.m.

PLACE: Courtroom 302

United States Bankruptcy Court  
21041 Burbank Blvd.  
Woodland Hills, CA 91367

1  
2 **I. INTRODUCTION**

3 The threshold issue of the Trustee's motion is whether the administration of an insurance trust  
4 account under California Ins. Code §1733 is a "Professional Service" as defined by the Essex  
5 Insurance Policy (the "Policy") that is the subject of this litigation. The Trustee's position – that  
6 administration of the Insurance Trust Account is a professional service - is supported by case law  
7 directly on point. See, *Utica Mutual Insurance Co. v. Miller*, ("Utica") 130 Md. App. 373 (2000)  
8 (insurance agent's acts of monitoring his business operations, maintaining records, and accounting to  
9 insurance company for premiums are "Professional Services" within the context of an broker's errors  
10 and omissions policy).

11 Essex contends the maintenance of the Trust Account is simply an accounting function and  
12 any claim regarding negligence in the administration of the Trust Account is not a Professional  
13 Service. In support of its position, Essex applies a strained analysis comparing the administration of  
14 an insurance trust account to that of an attorney's trust account or a medical service trust account,  
15 neither of which involve professional services directly related to the activities of their profession. The  
16 Insurance Trust Account is used to collect and pay premiums services that directly relate to the  
17 insurance broker's profession, in that premiums that are paid and collected are used to purchase or  
18 maintain the insurance policies, which is the very essence of the broker's business: the selling and  
19 maintenance of insurance policies. The broker's trust account requires a working knowledge of the  
20 insurance business, a knowledge of how commissions work and are to be deducted from the payments  
21 received and how refunds of policy premiums are to be allocated and paid, among many other  
22 payments and collections that are made from the Trust Account. Conversely, an attorney's trust  
23 account is simply a conduit for the receipt of monies which can be administered without the  
24 knowledge of the attorney's profession activities.

25 Without a meaningful response to the *Utica* decision, Essex simply rejects it as being  
26 wrongly decided, though the case has been cited with approval over 40 times by other courts.  
27 Essex cites to no case directly on point that supports its position. There are none. Having failed to  
28 distinguish *Utica*, Essex asserts a litany of insurance coverage fallback defenses, none of which  
are supported by the facts, as discussed below.

Moreover, having denied coverage and abandoned its policyholder, Essex is precluded by law from contesting the underlying factual basis of the claim. Under California law, Essex's coverage denial leaves it with only two possible defenses. The first is that there is no coverage under the Policy, because the claim does not fall within the scope of coverage under the terms of the Policy. This defense is a simple matter of insurance contract interpretation, because there is no factual dispute. [See "Plaintiff's Reply to Defendants Response to Plaintiff's Statement of Facts and Statement of Genuine Issues In Dispute to Opposition To Motion For Summary Judgment" ("Trustee's Reply SF") #'s 1-14, facts regarding the administration of CMM's trust account, all of which are admitted by Essex ].

Essex's other potential defense is to claim the settlement agreement was collusive, which also cannot be the case here. First, the settlement was achieved after a series of settlement conferences and the use of an experienced District Court judge as the mediator. Second the settlement and its terms were confirmed by the Bankruptcy Court as being fair, just and reasonable, and being in the best interests of the estate. Third, Essex was provided notice of the motion to approve the settlement, yet never made an appearance to object to the same. Having failed to do so, Essex is precluded from contesting the bona fides of the settlement.

Finally, Essex fails to present any material facts that would preclude the Court from granting summary judgment. Essex presents no expert testimony to support its contentions as to the administration of an insurance trust account, and as noted, has admitted all of the essential facts necessary to support a conclusion in favor of the Trustee.

## **II. DISCUSSION**

### **A. The Undisputed Facts Submitted By Plaintiff Must Be Accepted As True In Accord With Rule 56, and Local Rule 7056-1(f).**

Rule 56 of the Federal Rules of Civil Procedure pertaining to motions for summary judgment (made applicable to bankruptcy proceedings in Fed. Rules of Bankruptcy Procedure 7056) requires Essen to make an affirmative showing on all matters placed in issue by the Trustee's Motion for which Essex would have the burden of proof at trial. See *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986) (citing former Rule 56(e)(Rule 56 requires opposing party to designate specific facts and

1 evidence beyond the pleadings to refute matters that it would have burden to prove at trial). Essex  
2 cannot “sit back and wait for the [Trustee] to negate claims or defenses raised by the opposing party.”  
3 Schwarzer, et al., *Cal. Practice Guide: Federal Civil Procedure Before Trial* (The Rutter Group 2011)  
4 ¶ 14:145. “To avoid summary judgment, the opposing party must demonstrate a ‘genuine’ dispute as  
5 to any ‘material’ fact on all matters as to which it has the burden of proof.” *Id.* (citing *Celotex Corp.*,  
6 *supra*, 477 U.S. at 324). See also, Local Rule 7056-1 et seq.

7 “When the moving party has carried its burden ..., its opponent must do more than simply  
8 show that there is some metaphysical doubt as to the material fact.” *Matsushita Elec. Indus. Co., Ltd.*  
9 *v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986). “The mere existence of a scintilla of evidence ...  
10 will be insufficient; there must be evidence on which the jury could reasonably find for [the opposing  
11 party].” *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986).

12 At the summary judgment stage in insurance coverage actions, “[o]nce a prima facie showing  
13 is made [by the insured] that the underlying action fell within coverage provisions, an insurer may  
14 defeat a motion for summary judgment on the duty to defend only by producing undisputed extrinsic  
15 evidence conclusively eliminating the potential for coverage under the policy.” *Anthem Elecs., Inc. v.*  
16 *Pac. Emp’r Ins. Co.*, 302 F.3d 1049, 1060 (9th Cir.2002) (citation omitted) (emphasis added).  
17 “Evidence that merely place[s] in dispute whether [the insured’s] action would eventually be  
18 determined ... to fall within one or more of the exclusions contained in the polic[y] is insufficient to  
19 defeat the insured’s right to summary judgment.” *Id.* (citations omitted).

20 Here, Essex failed to produce undisputed extrinsic evidence that conclusively eliminates the  
21 potential for coverage. Essex’ entire defense is based upon its contention that the Rothman’s  
22 intentionally and knowingly looted the “piggy bank” (the “Trust Account”). However, Essex fails to  
23 produce any *undisputed extrinsic evidence* supporting its contentions. Instead, Essex draws  
24 conclusions of a willful and knowing default based upon the fact that the Rothman’s paid money to  
25 CMM to cover a Trust Fund shortfall, and evidence that CMM made payments on the Newport Beach  
26 Mortgage and on a boat owned by the Rothmans. There is no evidence (let alone undisputed  
27 evidence) that the Rothman’s knew, at the time of the payments, that the money being used was not  
28 owed to them for commissions, or that the payments caused an overdrawn situation in the Trust

1 Account at the time the payments were made, or that the Rothman's intentionally, willingly and  
2 knowingly abused the Trust Account, notwithstanding the facts demonstrate (as agreed to by Essex)  
3 that the Rothman's really had no idea they were even out of trust, until November or December 2011.  
4 [See Trustee's Reply SF #'s 15-17 ]. Moreover there has been no finding that the Rothman's  
5 changing of the "house accounts" to their accounts, was a fraudulent practice. To the contrary, this  
6 Court determined that the practice was *not* prima facie wrongful. [See Court's Memorandum of  
7 Opinion re Preliminary Injunction, Adversary Case No. 1:12-ap-01118-MT ECF Docket No. 100; 15-  
8 17:14-19 ] Essex' contention that there is no potential for coverage falls flat as Essex basically  
9 admits that the evidence is not conclusive but rather argues that there is some evidence which must be  
10 addressed before judgment can be entered. However, as presented in the Trustee's Reply SF, this  
11 flies in the face of Essex's obligation to submit undisputed evidence to support its contention that  
12 coverage does not exist.

13 **B. Maintaining An Insurance Trust Account Is A Professional Service.**

14 Essex disputes whether the underlying claims, which relate to CMM's management and  
15 administration of its statutory required trust account, arise out of CMM's "performance of or failure  
16 to perform professional services for others." The Policy defines CMM's profession as "insurance  
17 broker." Essex insists that the management and administration of the trust account is a simple  
18 ministerial task that does not fall within the concept of professional services.

19 The term "professional" has "long ceased to be connected and restricted exclusively to those  
20 so-called learned professions." *Hollingsworth v. Commercial Union Ins. Co.*, 208 Cal.App.3d 800,  
21 806-7, 256 Cal.Rptr. 357 (1989). Instead, "professional services" generally include services "arising  
22 out of a vocation, calling, occupation or employment involving specialized knowledge, labor, or skill  
23 ...." *Tradewinds Escrow, Inc. v. Truck Ins. Exch.*, 97 Cal.App.4th 704, 713, 118 Cal.Rptr.2d 561  
24 (2002). Applying California law, the Ninth Circuit has defined "professional services" broadly,  
25 holding that "[t]o be considered a 'professional service' for insurance purposes, a liability 'must arise  
26 out of the special risks inherent in the practice of the profession.'" *PMI Mortg. Ins. Co. v. Am. Int'l*  
27 *Specialty Lines Ins. Co.*, 394 F.3d 761, 766 (9th Cir.2005). In *Bank of Cal., N.A. v. W.H. Opie*, 663  
28 F.2d 997, 981 (9th Cir.1981), the Ninth Circuit rejected an insurance company's contention that a

1 claim against a mortgage banking corporation for violations of a loan agreement as to the proper  
2 allocation of funds it had borrowed from a bank did not arise out of a “professional service”, because  
3 there was no “professional-service relationship” between the mortgage banker and the lending bank.  
4 Rather, the court held that coverage was “dependent upon the nature of the insured’s conduct, not the  
5 status of the party harmed” and that “courts must look ‘to the act itself’ to determine whether the  
6 insured’s liability was predicated upon the faulty rendition of professional services.” *Id.* at 982  
7 (internal citations omitted).

8 The undisputed facts demonstrate that the management and administration of its statutorily-  
9 required trust account was a central element in CMM’s insurance brokerage business and is one of the  
10 “special risks inherent in” the profession of insurance brokering. *PMI*, 394 F.3d at 766. See also,  
11 *Utica*. The Trustee has presented expert testimony and supportive case law concluding that the  
12 management and administration of its statutorily-required trust account is a professional service  
13 essential to the business of obtaining insurance policies, collecting and paying premiums, financing  
14 premiums and resolving issues pertaining to the cancellation of policies, etc. See e.g. Michelson  
15 declaration, Trustee’s RJN, Exhibit 11. Essex offered no evidence to the contrary and cites to no case  
16 directly on point that addresses the issue presented by the Trustee’s Motion.

17 Instead, Essex argues that “professional services” cannot refer to the act of management and  
18 administration of its statutory required trust account. It argues that the such tasks do not require the  
19 professional’s “specialized knowledge, labor, or skill.” However, as *PMI* makes clear, the test of  
20 whether a liability arises out of a professional service is not what value was conveyed to the recipient  
21 of the service. Rather, it is whether the liability arises out of a risk inherent in the practice of the  
22 insured’s profession. The complexity of the management and administration of its statutory required  
23 trust account is well demonstrated by the evidence presented by the Trustee and by the conclusions  
24 set forth in *Utica*. Essex presents no evidence to the contrary (as it cannot now do) and no authority to  
25 support its position. Accordingly it must be concluded that the underlying claims, which all arise out  
26 of CMM’s insurance brokerage business, arise out of CMM’s “performance of or failure to perform  
27 professional services for others.” See generally *Utica*. See also, Michelson Declaration, RJN 11.

28 ///

1 The Court should give substantial weight to Michelson's opinion, particularly since Essex  
2 offers no evidence to the contrary. *Strickland v. Francis*, 738 F.2d 1542, 1552 (11th Cir.1984)  
3 (holding that finder of fact can reject uncontested expert testimony provided some basis in record  
4 exists for disregarding expert's opinion). Here, Essex offers no evidence "in the record" that could  
5 provide a basis for rejecting Michelson's opinion and there is nothing in the record that is contrary to  
6 his opinion.

7 Moreover, as presented in the Trustee's opening brief, the court in *Utica* found: "Accounting  
8 for premiums is generally a duty that an insurance agent owes to an insurance company, and is part of  
9 the agent's business (professional services). The insurance company may choose the agent, in part,  
10 because of his ability to maintain accurate records of the premiums for policies sold on behalf of the  
11 company." *Utica* at p. 389.

12 Essex's failure to contest the Trustee's undisputed fact presentation compels a finding that the  
13 maintenance of an insurance trust account is a professional service that falls outside the scope of a  
14 typical trust account. This factual finding is supported by the conclusion reached in *Utica*, a decision  
15 which cannot be ignored as Essex would ask the court do to.

16 The undisputed facts establish that that the Rothman Parties failed to monitor C.M.M.'s  
17 business operations, failed to maintain records, failed to account for premiums, and failed to properly  
18 audit the Trust Account activities. This is negligence, not an intentional misconduct as Essex would  
19 portray.

20 Importantly, several courts have noted that regulated professional activities (such as the  
21 practice of law or insurance brokering) have both professional and commercial components:[T]he  
22 practice of law, as other similarly regulated professional activity in today's world, has two very  
23 different and often overlooked components-*the professional and the commercial*. The professional  
24 aspect of a law practice obviously involves the rendering of legal advice to and advocacy on behalf of  
25 clients for which the attorney is held to a certain minimum professional and ethical standards. *The*  
26 *commercial aspect involves the setting up and running of a business, i.e., securing office space,*  
27 *hiring staff, paying bills and collecting on accounts receivable, etc.,* in which capacity the attorney  
28 acting as businessperson is held to the same reasonable person standard as any other. *Harad v. Aetna*

1 *Cas. & Sur. Co.*, 839 F.2d 979, 984 (3d Cir. 1988); *See also St. Paul Fire & Marine Ins. Co. v. ERA*  
2 *Oxford Realty Co. Greystone, LLC* 572 F.3d 893, 898 -899 (11th Cir. 2009) (“The majority of courts  
3 to address the issue have concluded that the term ‘professional services’ . . . excludes the business  
4 aspects of a professional practice that a professional happens to perform.”) (citing *Med. Records*  
5 *Assocs. v. Am. Empire Surplus Lines Ins. Co.*, 142 F.3d 512, 514 (1st Cir. 1998). However, while the  
6 management of a client trust account is a *commercial* component of running a law firm (that is, it is a  
7 necessary part of the firm’s own business operations), the management of an Insurance Trust Account  
8 is a *professional service* of an insurance brokerage firm. Clients hire attorneys to represent them with  
9 respect to legal matters; not to manage the firm’s own client trust account. Conversely, one of the  
10 reasons that insurance companies engage with insurance brokerage firms is to handle the collection  
11 and management of insurance premiums paid by policyholders. Payment premiums is an express,  
12 ongoing condition of every insurance policy sold by the insurance company. An essential role of the  
13 broker to be a go-between for the insurance carrier and the policyholder, and the Insurance Trust  
14 Account is a tool used in facilitating the monetary component of that relationship. Part of the broker’s  
15 obligation is to manage the collection of premiums, so that if the policyholder fails or refuses to timely  
16 pay its premiums, the carrier may follow the necessary statutory procedures to terminate the policy  
17 and the carrier’s risk thereunder. Thus, management of the Insurance Trust Account is not merely a  
18 commercial aspect of the broker’s own operations, but is an inherent aspect of the professional  
19 services the broker provides to its clients. *See e.g. Michelson Declaration, RJN 11.* Accordingly,  
20 given the precedent established by *Utica*, it is unquestionable that the management of an insurance  
21 broker’s trust account is a professional act that is covered by the terms of the Essex policy. As such,  
22 Essex had no basis to deny coverage and in doing so it breached the terms of its policy and its implied  
23 covenant of good faith and fair dealing.

24 **C. The Language of the Code and the Policy Compels Coverage for the Loss**  
25 **Sustained.**

26 Under California law, the maintenance of an Insurance Trust Account is not simply an  
27 administrative act akin to the maintenance of an attorney trust account. California Insurance Code  
28 §1733 et seq. Rather, it is a substantive element of an insurance broker’s professional services. As set

1 forth in the code, in addition to holding funds and then distributing them, the Broker (C.M.M.) may  
2 use the Trust Account “for the purpose of advancing premiums, establishing reserves for the paying of  
3 return commissions or for such contingencies as may arise in his business of receiving and  
4 transmitting premium or return premium funds, or...maintain[ing] such fiduciary funds pursuant to  
5 Section 1734.5.” This is not simple accounting, but instead requires specialized knowledge of the  
6 duties and obligations of insurance brokers in the ordinary course of their business.

7 Essex’s contends that the Court must look to the act itself that gives rise to the claim for  
8 coverage not the title or character of act itself. Essex then admits that to be considered a professional  
9 service the conduct must arise out of the insured’s performance of his specialized vocation or  
10 profession. The Trustee does not dispute these legal tenants. Rather the dispute here is Essex’s  
11 position that the maintenance of a broker trust account is merely an administrative function that does  
12 not require specialized knowledge. It is this premise that is in dispute, and Essex fails to offer any  
13 evidence contrary to the evidence presented by the Trustee, including the Michelson declaration, and  
14 further fails to offer any cases on point, as the Trustee did vis a vis *Utica*. As indicated in California  
15 Insurance Code 1734(b), an insurance broker maintains a trust account “for the purpose of advancing  
16 premiums, establishing reserves for the paying of return commissions or for such contingencies as  
17 may arise in his business of receiving and transmitting premium or return premium funds.” These  
18 functions require more than general accounting knowledge, they require in depth knowledge of the  
19 insurance business, how to calculate insurance premiums, commissions, and what factors to consider  
20 in establishing reserves – to wit; history of cancellations of policy, terminations, etc. The  
21 maintenance of an insurance trust account is, by definition, a professional service provided to another  
22 given the complexities of the same. See, Declaration of Larry Gabriel, Exhibit 1, Chris Marinescu and  
23 Emma Hart, “*From Concept to Practice: Insurance Trust Account Management*” Insurance Journal,  
24 August 6, 2012.

25 Further, Essex’s assertion that the inclusion of “for others” in the “Professional Services”  
26 definition in the Essex policy distinguishes this case from *Utica* is misplaced. The Essex definition of  
27 “Professional Services” is far from a model of clarity. The term is merely defined by example: “the  
28 following services rendered for others”, followed by an enumerated list of 16 items. One would

1 reasonably expect, given the prefatory language, that the list would include “services.” It does not.  
2 Rather, it includes a list of 16 professions and occupations. For example, item number 7, “Insurance  
3 Broker”, is not a service; it is an occupation. The occupation of Insurance Broker includes a number  
4 of services that one can provide to his or her client: the examination of risk, analysis of available  
5 insurance policies; acquisition of insurance policies; management of premiums, reporting of claims,  
6 etc. These are substantive professional services that an Insurance Broker provides “for others” (that  
7 is, for its clients) – they are not administrative services that the Insurance Broker performs for itself.

8       Moreover, the insuring agreement states that Essex shall pay all sums the Insured shall become  
9 legally obligated to pay as Damages “by reason of a Wrongful Act or Personal Injury in the  
10 performance of Professional Services rendered.” Neither the insuring agreement, nor the Wrongful  
11 Acts or Personal Injury definitions require that the claimant be the party to whom “Professional  
12 Services” were directly rendered. If an insured is alleged to have provided Professional Services “for  
13 others”, and it is further alleged to have committed a Wrongful Act or caused Personal Injury, they are  
14 entitled to a defense against such claims (and indemnification for all covered damages arising  
15 therefrom), irrespective of the identity of the claimant.

16       To interpret the Policy otherwise would be to interpret into the Policy an implied exclusion  
17 that is not found in the “conspicuous, plain, and clear” language in the Policy, as required by  
18 California law. See, *Certain Underwriters of Lloyd’s, London v. Superior Court* (2001).<sup>21</sup> Cal.4th  
19 545. Further, because of the declination of coverage, Essex is estopped from raising policy exclusions  
20 or non-coverage as a defense in the Trustee’s coverage action.

21       **D. Essex Breached Its Obligation To Provide A Defense To The Trustee’s Action**

22       The coverage obligations of Essex under California law are clear. It is well established that a  
23 liability insurer owes a broad duty to defend its insured against claims that create a potential for  
24 indemnity.” *Horace Mann Ins. Co. v. Barbara B.* (1993) 4 Cal.4th 1076, 1081; *Gray v. Zurich*  
25 *Insurance Co.*, (1966) 65 Cal.2d 263, 275. (“[T]he duty to defend arises whenever the lawsuit against  
26 the insured seeks damages on any theory that, if proved, would be covered by the policy. Thus, a  
27 defense is excused only when ‘the third party complaint can by no conceivable theory raise a single  
28 issue which could bring it within the policy coverage.’ [Citation.] It is settled that ‘the insured need

1 only show that the underlying claim may fall within policy coverage; the insurer must prove it  
2 cannot.’ [Citation.] Thus, an insurer may have a duty to defend even when it ultimately has no  
3 obligation to indemnify, either because no damages are awarded in the underlying action or because  
4 the actual judgment is for damages not covered by the policy. [Citation.] If coverage depends on an  
5 unresolved dispute over a factual question, the very existence of that dispute would establish a  
6 possibility of coverage and thus a duty to defend. [Citation.]” *Mirpad, LLC v. California Ins.*  
7 *Guarantee Assn.* (2005) 132 Cal.App.4th 1058, 1068, orig. italics; *Montrose Chemical Corp. v.*  
8 *Superior Court* (1993) 6 Cal.4th 287, 300; *Wausau Underwriters Ins. Co. v. Unigard Security Ins. Co.*  
9 (1998) 68 Cal.App.4th 1030, 1036; *Borg v. Transamerica Ins. Co.* (1996) 47 Cal.App.4th 448, 454.)

10 Whether a duty to defend exists in a given case is determined by examining “the policy, the  
11 complaint, and all facts known to the insurer from any source” *Montrose Chemical Corp. v. Superior*  
12 *Court*, supra, 6 Cal.4th at p. 300; *Gray v. Zurich Insurance Co.*, supra, 65 Cal.2d at pp. 276-277,  
13 including those facts the insurer “might have ascertained had [it] diligently pursued the requisite  
14 inquiry” into the details surrounding the tender of defense. *California Shoppers, Inc. v. Royal Globe*  
15 *Ins. Co.* (1985) 175 Cal.App.3d 1, 36-37. Here, Essex did not conduct any investigation into the facts  
16 upon which the claim was brought. Accordingly, the failure to do so is issue determinative of Essex’s  
17 coverage obligation.

18 Further, “in resolving whether the allegations in a complaint give rise to coverage under a  
19 [commercial general liability] policy, the courts consider the occurrence language in the policy, as  
20 well as the endorsements, if any, that broaden coverage included in the policy terms.” *Pardee*  
21 *Construction Co. v. Insurance Co. of the West* (2000) 77 Cal.App.4th 1340, 1351. “The rules  
22 governing policy interpretation require the court to look first to the language of the contract in order to  
23 ascertain its plain meaning or the meaning a layperson would ordinarily attach to it. [Citations.]”  
24 *Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 18. “If the meaning a layperson would  
25 ascribe to insurance contract language is not ambiguous, then the courts will apply it regardless  
26 whether legally trained observers would perceive the language as raising doubts as to coverage due to  
27 sophisticated legal distinctions. In other words, whatever ambiguity may attach to contract language  
28 due to a party’s legal knowledge is resolved in favor of coverage.” *Pardee Construction Co. v.*

1 *Insurance Co. of the West*, supra, 77 Cal.App.4th at p. 1352.

2 Here, the facts alleged in the claims tendered fall within the scope of coverage afforded under  
3 the Policy, triggering Essex's duty to defend. The Trustee's First Amended Complaint in Intervention  
4 alleges facts and claims potentially covered under the Policy, triggering Essex's duty to defend under  
5 the afore-outlined authorities.

6 **E. Essex's Opposition Is Limited By Law To Two Issues, Whether the**  
7 **Administration of the Insurance Trust Is A Professional Service; and,**  
8 **Whether The Settlement Between The Trustee And The Rothman Parties**  
9 **Was Collusive. Essex's Argument That The Rothman's Looted The Trust**  
10 **Account Is Irrelevant.**

11 Essex spends much of its brief in opposition accusing the Rothmans of stealing from the Trust  
12 Account, something vehemently denied by the Rothman's, Opposition pps. 1, 4,6-8, 16-19. Further  
13 exploiting this theme, Essex then claims that there is no coverage for the loss because of its conclusion  
14 that the Rothmans' committed dishonest acts.

15 These arguments may have been appropriate had Essex not denied coverage at the outset on  
16 the basic premise that the administration of the insurance trust account was not a Professional Service.  
17 See, Jacobson Declaration, Exhibits 1-3. Moreover, Essex's assumption of dishonesty based upon the  
18 allegations of the complaint, cannot be a basis for denying coverage. Because the Trustee resolved the  
19 litigation, Essex cannot challenge the factual underpinnings of the settlement and its theory and  
20 allegations that somehow dishonesty and not negligent mismanagement was involved is not a  
21 consideration for this litigation.

22 Courts that have generally examined the right of insurers to reopen and re-litigate the liability  
23 of their insureds for covered losses and resulting damages, which have already been established by  
24 third-party judgments, employ a distinct preclusion doctrine, which is more akin to the well-settled  
25 principles of contractual indemnity. *Burns v. California Fair Plan Assn.* (2007) 152 Cal.App.4th 646,  
26 653, 61 Cal.Rptr.3d 809 (insurance contract is a contract of indemnity).

27 When discussing an insurer's right to re-litigate its insured's liability, a leading treatise states  
28 the black letter rule in these terms: "One who has undertaken to indemnify another against loss arising

1 out of a certain claim and has notice and opportunity to defend an action brought upon such a claim is  
2 bound by the judgment entered in such action, and is not entitled, in an action against him for breach  
3 of his agreement to indemnify, to secure a retrial of the material facts which have been established by  
4 the judgment against the person indemnified.” 17 Couch on Insurance (3d. ed.2005) § 239:73, pp.  
5 239–88–239–89, fn. omitted.

6 California cases illustrating this proposition are legion, beginning with *Clemmer v. Hartford*  
7 *Insurance Co.* (1978) 22 Cal.3d 865, 151 Cal. Rptr. 285, 587 P.2d 1098 (“*Clemmer*”). In *Clemmer*, an  
8 individual who was insured by the Hartford Insurance Company (Hartford) killed Dr. Clemmer. Dr.  
9 Clemmer's family sued Hartford's insured for wrongful death and obtained a default judgment of over  
10 \$2 million. *Id.* at pp. 871–872, 151 Cal.Rptr. 285, 587 P.2d 1098. The family then sought to satisfy  
11 the default judgment in a direct statutory action against Hartford under Insurance Code section 11580.  
12 In finding that Hartford failed to protect its rights, the Supreme Court concluded: “Thus, under the  
13 circumstances, we hold that Hartford had ample opportunity to seek an adjudication of the damages. It  
14 knew or should have known that judgment against its insured would form the basis for a later claim  
15 against it under Insurance Code section 11580.” *Clemmer, supra*, 22 Cal.3d at p. 886, 151 Cal.Rptr.  
16 285, 587 P.2d 1098. Instead of protecting itself by seeking relief from default, Hartford “chose to  
17 remain silent, resting on its claim of noncoverage. Having failed to pursue remedies thus available to  
18 it, it cannot now claim prejudice or lack of opportunity to litigate damages.” *Ibid.* Without any  
19 discussion of privity, collateral estoppel, or the duty to defend, *Clemmer* established the simple rule  
20 that an insurer with an opportunity to “assume control and management of the suit” is not entitled to  
21 re-litigate damages as established by a valid third-party judgment against its insured. *Id.* at p. 885, 151  
22 Cal.Rptr. 285, 587 P.2d 1098.

23 It is now considered “well-settled” that “an insurer who is on notice of an action against its  
24 insured and refuses to defend on the ground the alleged claim is not within the policy coverage is  
25 bound by a judgment in the action, absent fraud or collusion, ‘as to all material findings of fact  
26 essential to the judgment of liability [and damages] of the insured.’ [Citations.]” *Schaefer/Karpf*  
27 *Productions v. CNA Ins. Companies* (1998) 64 Cal.App.4th 1306, 1313, 76 Cal.Rptr.2d 42, italics  
28 omitted.

1 Furthermore, to be enforceable against an insurer, a “judgment need not be based on a  
2 contested or adversarial trial, but may rest upon a default hearing held following a settlement  
3 [citations] or an uncontested trial where the insured settled with the claimant and thereafter presented  
4 no defense. [Citation.]” *Pruyn v. Agricultural Ins. Co.* (1995) 36 Cal.App.4th 500, 516–517, quoted in  
5 *Garamendi v. Golden Eagle Ins. Co.* (2004) 116 Cal.App.4th 694. This rule is illustrated in  
6 numerous cases. See, e.g., *Samson v. Transamerica Ins. Co.* (1981) 30 Cal.3d 220, 228, 236–242, 178  
7 Cal.Rptr. 343, 636 P.2d 32 (an insurer that refused to defend was bound by a judgment entered after  
8 its insured settled with the injured party); *Zander v. Texaco, Inc.* (1968) 259 Cal.App.2d 793, 799,  
9 804–806, 66 Cal.Rptr. 561 (an insurer that renounced coverage and defense was bound by a default  
10 judgment obtained after the insured did not appear at trial). In other cases, courts have relied on the  
11 express language of the insurance policy obligating an insurer to indemnify its insured, to trigger the  
12 insurer's obligation to pay a valid third-party judgment, notwithstanding the fact that the insurer had  
13 no notice of the underlying proceeding, thus depriving the insurer of any opportunity to defend the  
14 claim. *Home Indemnity Co. v. King* (1983) 34 Cal.3d 803, 815–816, 195 Cal.Rptr. 686, 670 P.2d 340  
15 (insurance company bound by stipulated judgment between injured person and insured even though  
16 insured failed to give insurance company notice of the underlying litigation or opportunity to defend  
17 the claim); *Kruger v. California Highway Indem. Exch.* (1927) 201 Cal. 672, 675–676, 258 P. 602  
18 (default judgment binding on insurer in the absence of fraud and collusion even though insurer was  
19 not a party to the action and had no notice of the action until after the judgment was rendered); *Belz v.*  
20 *Clarendon America Ins. Co.* (2007) 158 Cal.App.4th 615, 620, 69 Cal.Rptr.3d 864 (absent a showing  
21 of actual prejudice from the insured's failure to provide notice of a third-party claim, insurer not  
22 allowed to avoid its obligation to indemnify its insured when default judgment was taken against  
23 insured contractor.) Although these insurers had no notice or opportunity to participate in the defense  
24 of their insureds, courts have not allowed these insurers to avoid their contractual obligations based on  
25 a lack of privity, nor have the courts forced their insureds to undergo a second trial to once again  
26 determine liability and damages.

27 Thus, courts have sometimes found an insurer bound by the results of the third-party litigation  
28 against its insured based on the fact that the insurer refused to defend without legal justification. See,

1 e.g., *Amato v. Mercury Casualty Co.* (1997) 53 Cal.App.4th 825, 839 (well established in California  
2 that an insurer that wrongfully refuses defend is liable on the judgment); *Ceresino v. Fire Ins.*  
3 *Exchange* (1989) 215 Cal.App.3d 814, (same); *Pruyn v. Agricultural Ins. Co.*, *supra*, 36 Cal.App.4th  
4 at p. 517 (“The insurer not only had a right to participate in and to control the litigation, it had a duty  
5 to do so.”). See also, *Diamond Heights Homeowners Assn. v. National American Ins. Co.* (1991) 227  
6 Cal.App.3d 563, 580–583, 277 Cal.Rptr. 906 (an excess insurer with no duty to defend that is given  
7 notice of a settlement that invades its excess coverage has the choice of either assuming the defense or  
8 challenging the settlement on the grounds of unreasonableness, fraud or collusion—otherwise it is  
9 bound); *Fuller– Austin Insulation Co. v. Highlands Ins. Co.* (2006) 135 Cal.App.4th 958, 988,  
10 (primary insurer may negotiate a good faith settlement of a claim in an amount which invades excess  
11 coverage, and “ ‘may enter into [such settlement that] is binding on the excess insurer without the  
12 excess insurer's consent....’ ”); *Garamendi v. Golden Eagle Ins. Co.*, *supra*, 116 Cal.App.4th at pp.  
13 711–712, (insurance company could not re-litigate the issues it otherwise had a right to litigate had it  
14 decided to intervene in third-party lawsuit after insured's corporate status suspended and insurer was  
15 unable to defend in name of suspended corporation]; *Kaufman*, *supra*, 136 Cal.App.4th at pp. 224–  
16 225, (insurance company that represents insured whose corporate status has been suspended and for  
17 that reason cannot be defended in third-party litigation must intervene in the initial lawsuit if it wishes  
18 to participate; otherwise, issues necessarily decided in that litigation are conclusively established  
19 against the insurer).

20 The conduct of Essex in the handling of the claim falls in line with the case authority above  
21 discussed. Here, Essex, was (1) duly notified of the underlying claim against its insured (Jacobson  
22 Declaration, Exhibits 1-3); and (2) given a full opportunity to protect its interests as it had notice of  
23 the pendency of the action, and thereafter was given notice of the motions approving the settlements.  
24 See Request for Judicial Notice, Exhibit 3, p.92 (showing service on Essex’s coverage counsel,  
25 Andrew J. Waxler,, Waxler, Carner & Brodsky.) Had Essex wanted to contest the settlement or the  
26 appropriateness of the same, it had ample opportunity to do so. See generally, “*Consequences of*  
27 *liability insurer's refusal to assume defense of action against insured upon ground that claim upon*  
28 *which action is based is not within coverage of policy*,” 49 A.L.R.2d 694 (secs. 25, 26 superseded by

1 “Liability insurer's post loss conduct as waiver of, or estoppel to assert, “no-action” clause” , 68  
2 A.L.R.4th 389.) See also *National American Ins. Co. of California v. Certain Underwriters at Lloyd's*,  
3 1996 WL 459864 (carrier in breach of duty to defend may not subsequently assert policyholder's  
4 breach of cooperation clause as coverage defense).

5 Notwithstanding Essex had no right to be advised as to the proceedings, it was at all times kept  
6 apprised of developments, and even provided the opportunity to object to the settlement. Having  
7 waived that right, it cannot now complain that somehow it should have been provided greater notice of  
8 events than were provided to Essex as a courtesy and not a right.

9 **F. The Trustee's claim is not barred by the Policy's “insured vs. insured”**  
10 **exclusion.**

11 Essex contends that the Policy's “insured v. insured exception precludes coverage for the  
12 claims brought by the Trustee. Policy Exclusion E states that “The policy does not apply to any  
13 Claim:... by or on behalf of another Insured.” [SSUF 51 (Policy Exclusions E.)] The Policy defines  
14 “insured” as set for in insuring provision (f) as:

15 Insured either in the singular or plural means:

- 16 1. the Named Insured herein defined as the person(s) or  
organization(s) stated in Item 1. Of the Declarations;
- 17 2. any Predecessor Organization of the Named Insured;
- 18 3. any past or current principal, partner, officer, director, trustee,  
shareholder or employee of the Named Insured or its Predecessor  
19 Organization solely while acting on behalf of the Named Insured or  
its Predecessor Organization and within the scope of their duties as  
20 such;
- 21 4. if the Named Insured stated in Item 1. Of the Declarations is  
limited liability company [remained not applicable];
- 22 5. any natural person who is an independent contractor of the Named  
Insured or is Predecessor solely while acting on behalf of the Named  
23 Insured or its Predecessor Organization and within the scope of their  
duties as such; and
- 24 6. the spouses and legally recognized domestic partners of  
Insureds...;
- 25 7. the heirs, executors, administrators, assigns and legal  
representatives of each Insured above in the event of death,  
26 incapacity, or bankruptcy of such Insured but only for such Insured's  
liability as otherwise covered herein.

27  
28 Thus, relevant to this Motion, the policy defines Insured by reference to six initial classes of  
persons or organizations, and then a seventh class that includes various third parties who may, be way

1 of circumstance, come to stand in the shoes of an Insured. It is readily apparent from a cursory review  
2 of the definition that a bankruptcy trustee does not qualify under any of the first six initial classes of  
3 Insureds. Thus, in order for the Insured v. Insured exclusion to apply to this claim, the bankruptcy  
4 trustee must qualify under the seventh class of Insureds. However, that seventh class has several  
5 notable limitations, and a careful examination of those factors demonstrates why the definition (and  
6 therefore the exclusion) does not apply under the facts of this claim.

7 First, to qualify as an Insured under subpart 7 of the definition, a person must be an heir,  
8 executor, administrator, assign or legal representation of an insured. A bankruptcy trustee is none of  
9 these.

10 Under the Bankruptcy Code, the bankruptcy trustee may bring claims founded on the rights of  
11 the debtor and to an extent, certain rights of the debtor's creditors. See e.g., 11 U.S.C. §§ 541, 544,  
12 547. Upon the filing of a petition for relief under the Bankruptcy Code, any claims belonging to the  
13 company pre-petition automatically, by operation of law, become property of the bankruptcy estate.  
14 See 11 U.S.C. § 541(a)(1) (providing that upon the filing of a petition a bankruptcy estate is created  
15 comprised of “all legal or equitable interests of the debtor in property as of the commencement of the  
16 case”). *In re International Gold Bullion Exchange, Inc.*, 60 B.R. 261, 263 (Bankr.S.D.Fla.1986) (“... a  
17 trustee, like a debtor-in-possession, is conceptually separate for purposes of bankruptcy law; indeed, it  
18 is well established that even a debtor-in-possession which is, in actuality, the same entity as the debtor  
19 is nevertheless deemed to be separate and distinct from the debtor under bankruptcy law ...”).

20 Pursuant to § 323, the trustee, and only the trustee, can sue and be sued on behalf of the estate.  
21 See 11 U.S.C. § 323. When the trustee commences an action, he is doing so on behalf of the estate,  
22 the debtor entity, the shareholders and the creditors, in furtherance of his duty as defined by Congress.  
23 The debtor, shareholders and creditors are all barred from asserting the claims. *Gore v. Kressner*, 159  
24 B.R. 428, 431–32 (Bankr.S.D.N.Y.1993); *In re Granite Partners, L.P.*, 194 B.R. 318, 325  
25 (Bankr.S.D.N.Y.1996). The Ninth Circuit is in accord: See *Unified Western Grocers, Inc. v. Twin*  
26 *City Fire Ins. Co.* (9th Cir. 2006) 457 F3d 1106, 1116–1117. See also, *Alstrin v. St. Paul Mercury*  
27 *Ins. Co.* (D DE 2002) 179 F.Supp.2d 376, 403–405; *In re Buckeye Countrymark, Inc.* (BC SD OH  
28 2000) 251 BR 835, 840 (contra)—bankrupt corporation and its trustee in bankruptcy are separate legal

1 entities and trustee's claims against officers and directors are therefore not barred by insured vs.  
2 insured exclusion]

3       The issue presented in this case was addressed by the Florida Court of Appeals in the case of  
4 *Rigby v. Underwriters at Lloyd's, London*, 907 So.2d 1187 (Fla. 3rd Dist.Ct.App.2005). In *Rigby*, the  
5 court held that an *insured vs. insured* exclusion contained in the liability insurance policy did not bar  
6 coverage for an action against a former director of a corporation that was brought by a bankruptcy  
7 trustee. T. Alec Rigby, was a former president and director of Atlas Environmental, Inc. ("Atlas"). See  
8 *id.* at 1188. Atlas filed for Chapter 11 bankruptcy relief in 1999, the case was subsequently converted  
9 to Chapter 7, and Soneet Kapila ("Kapila") was appointed permanent Chapter 7 Trustee. *Id.* Before  
10 the bankruptcy filing, Underwriters at Lloyd's, London ("Lloyd's") issued a Directors and Officers  
11 Liability and Company Reimbursement policy to Atlas, and continued to issue renewals of the policy  
12 during the bankruptcy proceedings. *Id.* After his appointment as Chapter 7 trustee, Kapila requested  
13 that Lloyd's list him as an insured under the policy. *Id.* In response, Lloyd's for an additional premium,  
14 issued endorsements to the policy, adding Kapila as an insured. *Id.*

15       In 2000, *Kapila*, specifically as trustee, filed an adversary complaint against Rigby on behalf  
16 of Atlas' creditors in the bankruptcy proceeding for Rigby's negligence and breach of his fiduciary  
17 duties as an Atlas officer. *Id.* Rigby sought defense and indemnification of the trustee's claims from  
18 Lloyd's pursuant to the directors and officers liability policy. *Id.* In response, Lloyd's denied coverage  
19 under the policy's insured vs. insured exclusionary clause. The clause provided "[Lloyd's] shall not be  
20 liable to make any payment in connection with any Claim ... by, on behalf of, or at the direction of any  
21 of the Assureds ..." *Id.* at 1188–89. The Rigby court rejected the argument that Rigby was excluded  
22 from coverage under the policy pursuant to the insured vs. insured exclusion because Kapila is defined  
23 as an officer or director under the policy. The court stated: "Kapila's endorsement as an officer or  
24 director did not detract from his function as trustee. Kapila as trustee had filed suit against Rigby on  
25 behalf of Atlas' creditors, based upon his statutory duties as trustee under 11 U.S.C. §§ 704(1) and  
26 704(4) to collect and reduce to money the property of the estate for the benefit of the debtor's  
27 creditors. Kapila did not bring the adversary action acting as an officer or director. As a result the  
28 insured versus insured exclusion did not apply. *Id.* (footnote omitted). See also, *In re Molten Metal*

1 *Technology, Inc.*, 271 B.R. 711, 729 (Bankr.D.Mass.2002) (holding that “the Chapter 11 Trustee is not  
2 the legal equivalent of the Debtor.”); *In re County Seat Stores, Inc.* 280 B.R. 319, 325  
3 (Bankr.S.D.N.Y.2002) (holding that “a bankruptcy trustee is a legal entity separate and distinct from  
4 the debtor.”); *In re Buckeye Countrymark, Inc.*, 251 B.R. 835, 840 (Bankr.S.D.Ohio 2000) (a  
5 bankruptcy trustee is not the debtor's alter ego but a separate legal entity that neither represents the  
6 Debtor nor owes the Debtor a fiduciary obligation and whose responsibility is to the bankruptcy  
7 estate).

8         The Trustee is prosecuting those claims on behalf of the estate and for the benefit of those  
9 having valid claims against it, among whom the Debtor stands last in priority. As noted in *Molten*  
10 *Metal Technology*: [W]hile it is certainly true that a trustee “stands in the shoes of the debtor” when  
11 prosecuting causes of action that arose in favor of the debtor before the commencement of the  
12 bankruptcy case, it also true that this doctrine does not mean that the trustee is the debtor. It only  
13 means that the trustee, despite his or her nonidentity with the debtor, is nonetheless subject to such  
14 defenses as the defendant has against the debtor. *In re Molten Metal Technology*, at 729–30.

15         Simply stated, a bankruptcy trustee charged with a statutory duty and endowed with special  
16 statutory powers, is an independent and disinterested entity, separate and distinct from the debtor, as  
17 well as the prepetition company, and as such does not strictly “stand in the shoes” of the debtor. Nor  
18 does he assume the identity of the debtor. *In re County Seat Store*, at 326. Based on this reasoning,  
19 the debtor does not own the claims and cannot bring the claims in this action. Rather, the bankruptcy  
20 trustee is prosecuting the claims on behalf of the estate and for the benefit of creditors having valid  
21 claims against it and he is not prosecuting these claims “by, on behalf of, in right of the Insured  
22 Entity.” In the very unlikely event that the Trustee's recovery pays all administrative expenses and  
23 creditors' claims in full and there remains a surplus in which the Debtor might have some interest, the  
24 insured vs. insured exclusion may come into play; but, by the very nature of the depth of insolvency in  
25 this case and in light of the fact that the Policy proceeds are limited to \$5,000,000 in the aggregate, the  
26 Debtor will very likely receive nothing from the Trustee's recovery. Thus, for all intents and purposes,  
27 under the terms of the Policy, the Trustee in this case is a legal entity separate and distinct from the  
28 Debtor, prosecuting claims that are not the Debtor's, therefore, the “insured vs. insured exclusion” in

1 the Policy does not apply.

2       It must also be noted that in contrast to the Policy in this case, there are liability policies that  
3 explicitly exclude coverage when suits are brought by bankruptcy trustees or debtors in possession.  
4 See *TIG Speciality Insurance Company v. Koken*, 855 A.2d 900, 909 (Pa.Comm. Ct. 2004) (finding  
5 that a director and officer liability policy that stated coverage “does not apply to any Claim made  
6 against any Insured arising out of ... Any Claim brought by, on behalf of or at the behest of the  
7 Company, its successor, its assignee, its trustee in bankruptcy, its debtor-in-possession, or its litigation  
8 trustee” barred coverage). Here, the plain language of the definitions and the exclusion do not include  
9 the bankruptcy trustee *vis a vis* claims brought by the Trustee. As discussed herein, the bankruptcy  
10 trustee is not asserting the claims “by, on the behalf of, or in the right of the Insured Entity” but has  
11 instituted the claims on behalf of the estate and for the benefit of its creditors.

12       Finally, the omission of a bankruptcy trustee from the Policy exclusion language indicates the  
13 exclusion does not apply. If Essex wanted to include the bankruptcy trustee, it could have expressly  
14 provided so by plainly excluding claims brought by the “Insured Entity's trustee in bankruptcy.” This  
15 finding is in keeping with California law that exclusionary provisions which are ambiguous or  
16 otherwise susceptible to more than one meaning must be construed in favor of the insured.” See e.g.  
17 *Haynes v. Farmers Ins. Exch.*, 32 Cal.4th 1198, 1204, 13 Cal.Rptr.3d 68, 89 P.3d 381 (2004) (quoting  
18 *Steven v. Fidelity & Casualty Co.*, 58 Cal.2d 862, 878, 27 Cal.Rptr. 172, 377 P.2d 284 (1962)  
19 (coverage may be limited by exclusionary clauses only to the extent that those clauses are  
20 “conspicuous, plain and clear.”); *MacKinnon v. Truck Ins. Exch.*, 31 Cal.4th 635, 648, 3 Cal.Rptr.3d  
21 228, 73 P.3d 1205 (Cal.2003). ( “[I]nsurance coverage is interpreted broadly so as to afford the  
22 greatest possible protection to the insured, [whereas] ... exclusionary clauses are interpreted narrowly  
23 against the insurer.”).

24       Even assuming that the bankruptcy trustee could qualify as a “legal representative”, it would  
25 still have to meet the remaining criteria of the definition to qualify as an Insured. The second  
26 condition dictates that, although a legal representative can be considered an Insured, it is and Insured  
27 only “for such Insured’s liability as otherwise covered herein.” Critically, the definition makes clear  
28 that a legal representative who qualifies as an Insured under the 7<sup>th</sup> cause is an Insured “only for such

1 Insured's liability." The purpose of this clause is self-evident: if an Insured dies, becomes  
2 incapacitated or files for bankruptcy, the party who steps in that Insured's shoes is an Insured for the  
3 purpose of responding to (and attaining coverage for) claims against that Insured. Thus, while a legal  
4 representative is an Insured under the definition when a claim is made *against* it for liabilities of the  
5 primary Insured (so as to secure coverage under the Policy), the legal representative will never be an  
6 Insured when it *pursues* affirmative claims against others, because that function does not involve the  
7 primary Insured's liability. Accordingly, under the language selected by Essex when it drafted the  
8 Policy, the Insured v. Insured exclusion can never apply to a legal representative who pursues claims  
9 against Insureds under the policy, as the Trustee has done here.

10 Essex contends that the capacity clause in the exclusion ("but only for such Insured's liability  
11 as otherwise covered herein") is intended simply to carve out from coverage claims against the  
12 Trustee completely unrelated to CMM (such as, related to his work at Development Specialists, Inc.).  
13 While that certainly would be one effect of the exclusion, it is certainly not the only consequence. To  
14 the contrary, by defining a legal representative's status as an Insured with respect to "liability", the  
15 Policy delineates a clear limitation as to the status of a legal representative as an "Insured", not just a  
16 limitation as to the scope of coverage afforded to it. If Essex' sole intention in drafting the definition  
17 was to limit coverage to a legal representative to matters associated with the Named Insured, it could  
18 have done so far more clearly by omitting the "but only for such Insured's liability as otherwise  
19 covered herein" clause from the definition, and adding a separate exclusion addressing the desired  
20 restriction. Alternatively, Essex could have avoided this dispute entirely had it included a clearly-  
21 worded exclusion barring coverage for all actions by a bankruptcy trustee for any Insured brought  
22 against any other Insured, a practice that is very common in the insurance industry. See *TIG*  
23 *Speciality Insurance Company v. Koken*, 855 A.2d 900, 909 (Pa.Comm. Ct. 2004). Essex chose not  
24 to do so. Instead, the language of the Insured v Insured exclusion, applied strictly, reflects that it  
25 cannot apply to the Trustee's claim here; because the Trustee is an Insured under the Policy "only for  
26 [CMM's] liability," and not for the purpose of CMM's affirmative claims. If Essex had desired a  
27 different outcome, it should have drafted its exclusion accordingly.

28 ///

1 For the reasons set forth herein “insured vs. insured” exclusion in the Policy does not bar the  
2 Trustee’s claim for coverage.

3 **III. CONCLUSION**

4 For the foregoing reasons, summary judgment should be entered in favor of the Trustee as  
5 prayed for in the Moving Papers.

6

7

8 DATED: October 7, 2014

LARRY W. GABRIEL  
JENKINS MULLIGAN & GABRIEL, LLP

9

10

By: /s/ Larry W. Gabriel  
Larry W. Gabriel  
Special Litigation Counsel for Bradley D. Sharp,  
Chapter 11 Trustee, Estate of C.M.Meiers

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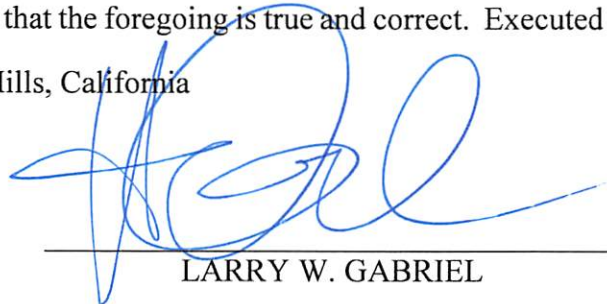
DECLARATION OF LARRY W. GABRIEL

I, Larry W. Gabriel, declare as follows:

1. I am an attorney at law, duly licensed to practice in the State of California and admitted to practice before this court. I am a partner of the law firm, Jenkins Mulligan & Gabriel, LLP. I am special litigation counsel to Bradley D. Sharp, the chapter 11 trustee, estate of C.M. Meiers, bankruptcy case no. 1:12-bk-10229-MT. I know the contents declared herein to be true of my own personal knowledge and belief, and if called upon could and would competently testify thereto.

2. Attached hereto is an article by Chris Marinescu and Emma Hart, "From Concept to Practice: Insurance Trust Account Management" Insurance Journal dated August 6, 2012 demonstrates the complexity of the administration of an insurance trust account management <http://www.insurancejournal.com/magazines/ideaexchange/2012/08/06/257776.htm>. A true and correct copy of the article is attached hereto as Exhibit "1."

I declare under the penalty of perjury that the foregoing is true and correct. Executed this the 10<sup>th</sup> day of November, 2014 at Woodland Hills, California



LARRY W. GABRIEL

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## From Concept to Practice: Insurance Trust Account Management

By Chris Marinescu and Emma Hart | August 6, 2012

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The concept of trust account (TA) management has no meaning to many professionals, or they have no uniform understanding of it. There are no text books or college classes on insurance TA management, and insurance-based publications seldom organize discussions to debate TA management's critical importance to the P/C insurance agency business.

Most insurance agency owners interpret TA management as a simple process of receiving premium payments from insureds and writing checks to carriers or general agents. Agency commission income is not formally managed; most agencies transfer commission funds to the operating account based on what they need rather on what they "earn." Return premiums are treated as "negative receivables," and premium credit and refunds are managed outside the general accounting system.

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Premium payments and company remittance are indeed critical to any insurance agency. But is this all trust account management is about?

### Insurance Code Mandates

Insurance code requires agency owners to receive premiums in a "fiduciary" capacity, not as owners but "custodians" of funds. On this basis, insurance code requires agency owners to maintain separate "trust" bank accounts for premiums and return premiums so they can be separated from the agency's business operating funds. A separate trust bank account protects premium funds from agency creditors.

Any premium payment deposited in an agency's trust bank account becomes "fiduciary" fund subject to insurance code regulations. One is not permitted to take funds out of the trust bank account without proper documentation of the amount of commission "earned" and an audit trail.

### Premium and Commission Management

TA management can be suitably defined as "premium and commission management." Agencies receive premium payments, generally in small amounts, policy by policy, invoice by invoice. The invoice process and especially that of endorsements is tedious and frequently requires follow-up to avoid delinquencies. Mismanaging receivables is a major cause of TA insolvency. Receiving premiums on schedule and remitting them to carriers or general agents, net of commission, is an agency's primary focus.

No formal agency commission management procedure is provided by current agency management systems. Agencies lack the necessary financial tools to determine their "earned" commission, and most transfer commission funds based on what they need. The uncontrolled transfer of commission funds to the operating account has been a major cause of TA insolvency.

### Money Management

The "premium and commission management" characterization overlooks the financial character of the TA operation. An insurance agency's financial traffic in and out of the trust bank account can be significant, \$5 million to \$10 million a year in small agencies, and \$50 million or more a year in large agencies. Tracking bank deposits and disbursements requires accurate accounting records and a reliable reporting system. Thus, it is only natural that TA management should be viewed as "money management."

### Premium Financial Management

TA management is, however, a lot more than money management. Premium funds are by law "earmarked" funds with a predetermined destination. They require tracking at the policy level. A \$1,000 premium received by an agency for policy A underwritten by one carrier cannot be used to remit the premium of another policy B underwritten by a different carrier. Policy premium management requirements could be looked at as a comprehensive "financial management." Accounting procedures and especially the premium reporting system must be detailed and reliable, as premiums are not simply money but "fiduciary" funds.

### Financial Solvency Management

Insurance code requires the trust bank account balance to equal at least the amount of the net premium "due to the persons entitled thereto." Failure to meet this requirement is essentially proof of financial insolvency. On this basis, TA management can be defined as "premium solvency management."

Financial solvency is the ultimate management goal of insurance TA "custodians." Under the insurance code standard, licensed insurance brokers are personally responsible for insurance TA solvency.

In current practice, the amount of net premium "due to the persons entitled thereto" cannot be reliably determined, especially when the "cash solvency" is investigated. Current "trust position" or "trust ratio" indicators are somehow helpful, but they are unreliable. They cannot

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characterize the TA “cash solvency,” and the accuracy of accounting records is highly questionable.

### Premium Liability Management

The carrier-agent/broker agreement compels insurance retailers to remit transacted premiums to carriers, net of commission, whether or not they receive premium payments from insureds. To avoid earned premium liabilities in case of non-payment of premium, they are entitled to request the policy cancellation.

By virtue of the carrier-broker agreement, a \$10,000 premium transaction automatically creates a \$9,000 premium liability for the broker (10 percent commission assumed). The agency’s concern should therefore be not only to realize a \$1,000 commission but also to protect the broker against a \$9,000 potential loss.

Considering the book of business of most agencies is multi-million dollar in size, one could justifiably define TA management as “premium liability management.” To manage liability of this magnitude, insurance brokers need to set up a functional TA operation.

### Trust Account Management Concept

A financially solvent insurance TA guarantees all transacted premiums and commissions, as well as transacted premium liabilities, are properly managed.

TA financial solvency is not uniformly understood primarily because insurance professionals seem unaware of insurance code mandates, and regulatory agencies fail to consistently enforce them. In today’s high-tech age, insurance brokers should be able to review simple premium financial solvency reports daily. They are too important to be left to just a casual examination.

To comply with insurance code mandates, a reliable financial solvency reporting system should assure insurance brokers:

- Each policy is financially solvent;
- Premiums owned by each carrier are financially solvent; and
- An agency’s entire TA is financially solvent.

These financial instruments are sufficient to monitor and report TA financial solvency:

- TA balance sheet;
- Solvency analysis reports;
- Cash solvency report;
- Cash and receivable solvency report;
- Premium float statement; and
- Statement of trust funds beneficiaries.

A TA balance sheet will demonstrate trust assets equal trust liabilities. This report is currently unavailable because general ledger accounting does not support it. The main reason why this report cannot be produced is the premium invoice format, which treats commission liability as “income.”

Solvency analysis reports are produced by processing the balance sheet data. They will show either a “premium surplus” or “premium deficit” for each policy, carrier, and agency. Solvency analysis reports will be available on a “cash basis” to demonstrate an agency has sufficient cash and credit assets to meet “due and payable” liabilities.

A premium float statement is similar to the P&L statement available in general ledger accounting. By listing premium receipts and disbursements, this report determines the “premium float” at all three levels: policy, carrier and agency. A policy or the whole TA is solvent when the bank account cash balance equals the premium float.

The statement of trust funds beneficiaries is generated by processing the premium float statement data. This report will list the “owners” (beneficiaries) of the TA cash balance. A TA cash balance has potentially five beneficiaries: carriers (net premiums), general agents (net

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premiums), agency (earned commission), insureds (return premiums, overpayments), and premium finance companies (return premiums).

### Trust Account Management Practice

The practice of TA management is either scarce or entirely lacking mainly because TA operation is unusually complex. To manage it properly in accordance with insurance code mandates, insurance brokers need better accounting and a standardized financial solvency reporting system.

The "trust ratio" or "trust position" indicators are of limited help. Better reporting is required to monitor and control the TA financial solvency.

Automation and the Internet can now elevate the insurance TA management practice to the high standard of care insurance premium "custodians" need.

### About Chris Marinescu and Emma Hart

Marinescu is president of Paulmar Group LLC. Hart is a director of insurance agency operations in Orange County, Calif. Email: [chris@paulmargroup.com](mailto:chris@paulmargroup.com), [emma@emmahart.com](mailto:emma@emmahart.com).

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- United States Trustee (SV) ustregion16.wh.ecf@usdoj.gov
- Daniel C. Streeter daniel.streeter@troutmansanders.com, cathe.zinn@troutmansanders.com

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